

REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

October 14, 2003

REVENUE MEMORANDUM CIRCULAR NO. 66-2003

SUBJECT : Clarifying the Taxability of Philippine Airlines (PAL) for Income Tax Purposes As Well as Other Franchise Grantees Similarly Situated.

TO : All Internal Revenue Officers and Others Concerned.

I. Taxability of PAL and Other Franchise Grantees Similarly Situated.-

In consideration of the franchise and rights granted by the Government to Philippine Airlines (PAL) pursuant to Presidential Decree No. 1590, Section 13 thereof provides that *'the grantee shall pay the Philippine Government during the life of this franchise whichever of subsections (a) or (b) hereunder will result in a lower tax:*

"(a) The basic corporate income tax based on the grantee's annual net taxable income, computed in accordance with the provisions of the National Internal Revenue Code; or

"(b) A franchise tax of two percent (2%) of the gross revenues derived by the grantee from all sources, without distinction as to transport or non-transport corporations; provided that with respect to international air transport services, only the gross passengers, mail and freight revenues from its outgoing flights shall be subject to this tax.

"xxx xxx xxx"

As can be gleaned above, the legislative charter of PAL clearly provides two options for the payment of income tax, namely, the normal corporate income tax imposed on domestic corporations under Section 27(A) of the Tax Code of 1997 (Code) or the 2% franchise tax mentioned in item (b) of the aforementioned provision, whichever is lower.

Given that PAL has been operating at a loss for many years, it is evident that in applying the provisions of Section 13 of said Charter, for the computation of its income tax liability, it chose to use the normal corporate income taxation under

Section 27(A) of the Code as basis thereof in order to exempt itself from tax liability. This is without, however, considering the adjunct provision introduced by RA 8424 on the imposition of minimum corporate income tax (MCIT).

Section 27(E) of the Code, as implemented by Revenue Regulations No. 9-98, provides that MCIT of two percent (2%) of the gross income as of the end of the taxable year (whether calendar or fiscal year, depending on the accounting period employed) is imposed upon any domestic corporation beginning the 4th taxable year immediately following the taxable year in which such corporation commenced its business operations. The MCIT shall be imposed whenever such corporation has zero or negative taxable income or whenever the amount of MCIT is greater than the normal income tax due from such corporation.

With the advent of such provision beginning January 1, 1998, it is certain that domestic corporations subject to normal income tax as well as those choose to be subject thereto, such as PAL, are bound to pay income tax regardless of whether they are operating at a profit or loss.

Thus, in case of operating loss, PAL may either opt to subject itself to minimum corporate income tax or to the 2% franchise tax, whichever is lower. On the other hand, if PAL is operating at a profit, the income tax liability shall be the lower amount between:

- (1) normal income tax or MCIT whichever is higher; and
- (2) 2% franchise tax.

Example :

(1.a) Normal income tax of	P 20,000
(1.b) MCIT	P 40,000
(1) Higher amount between (1.a) and (1.b)	P 40,000
(2) 2% Franchise Tax	P 30,000
(3) Income Tax (lower amount between 1 and 2)	P 30,000
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The same method for the computation of income tax is applicable to other franchise grantees whose respective legislative charters have likewise granted them the option to compute their income tax liability in the manner provided in PD 1590.

II. Items of Gross Revenue and Cost of Service of PAL for MCIT Purposes. -

For purposes of applying MCIT on the gross income of PAL, its "gross revenue" and "cost of service" shall consist only of the following items:

(a) Gross Revenue -

- (1) Passenger Revenue;
- (2) Cargo Revenue;
- (3) Other Transport Revenue; and
- (4) Non-Transport Revenue.

(b) Cost of Service

- (1) Salaries, wages and other employee benefits directly engaged in the transport of passenger, cargo or mail;
- (2) Commissions paid to sales agents;
- (3) Fuel and oil used in transport equipment/aircraft;
- (4) Insurance expenses incurred which are directly connected to transport activities (e.g. hull insurance, passenger liability insurance, and the like)
- (5) Traffic servicing expenses;
- (6) Aircraft servicing expenses;
- (7) Passenger service expenses;
- (8) Depreciation of and/or lease/rental charges for aircraft, flight equipment and ground equipment; and
- (9) Maintenance and repairs of aircraft, flight and ground equipment.

This Circular supplements Revenue Memorandum Circular No. 4-2003, dated December 31, 2002. All revenue officers and others concerned are hereby enjoined to give this Circular as wide a publicity as possible.

(Original Signed)
GUILLERMO L. PARAYNO, JR.
Commissioner of Internal Revenue